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No. 87-314

IN THE SUPREME COURT OF THE UNITED STATES
October Term, 1987

QUALITY MARKETS, INC.,
Appellant

v.

COMMONWEALTH OF PENNSYLVANIA,
Appellee

On Appeal from the Supreme Court
of Pennsylvania

MOTION TO DISMISS OR AFFIRM

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TABLE OF CONTENTS

	Page(s)
TABLE OF CITATIONS	ii
MOTION TO DISMISS OR AFFIRM....	1
ARGUMENT.....	2
I. PENNSYLVANIA'S ELECTIVE APPORTIONMENT PROVISIONS	2
II. THE PENNSYLVANIA SYSTEM OF APPORTIONMENT IS CONSTITUTIONAL.....	8
III. THE RESULT SOUGHT BY THE APPELLANT WOULD CREATE AN UNCONSTITUTIONAL DISCRIMINATION BETWEEN FOREIGN AND DOMESTIC CORPORATE TAXPAYERS.....	11
CONCLUSION.....	13

TABLE OF CITATIONS

	Page(s)
Cases:	
Commonwealth v. After Six, Inc., 489 Pa. 69 (1980).....	6, 7, 12
Commonwealth v. Ford Motor Co., 350 Pa. 236 (1944), appeal dismissed 324 U.S. 827 (1945).	10
Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983).....	3
Exxon Corp. v. Department of Revenue of Wisconsin, 447 U.S. 207 (1980).....	9, 10,
Gilbert Associates, Inc. v. Commonwealth, 498 Pa. 514 (1982).....	5, 11, 12
Greenville Steel Car v. Commonwealth, 469 Pa. 444 (1976).....	4
Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 475 (1980).....	9

TABLE OF CITATIONS
(Continued)

Western & Southern Life Ins. Co. v. State Board of Equalization of California, 451 U.S. 648 (1981)..... 5, 6, 12

WHYY, Inc. v. Borough of Glassboro, 393 U.S. 117 (1968) 6, 12

Statutes

72 Pa. Stat. Ann.
§1896 (Purdon 1949)..... 3
§7401(3)2(a)(10)-(17) (Purdon Supp. 1982)..... 3
§7601, et seq. (Purdon Supp. 1982)..... 2, 3
§7602 (Purdon Supp. 1982)..... 3, 5

MOTION TO DISMISS OR AFFIRM

The Commonwealth of Pennsylvania, by counsel, hereby moves this Court to dismiss the present appeal for want of a substantial federal question, or, in the alternative, to affirm the judgment of the Supreme Court of Pennsylvania because the questions on which the determination of this appeal depend are so insubstantial as not to warrant further argument.

ARGUMENT

I. PENNSYLVANIA'S ELECTIVE APPORTIONMENT PROVISIONS.

This appeal involves the constitutional validity of the alternative apportionment methods available to non-Pennsylvania corporations on an elective basis.

Pennsylvania imposes parallel taxes based upon value on domestic and foreign corporations which do business in Pennsylvania. Pennsylvania chartered companies (domestics) pay the Capital Stock Tax, while those chartered elsewhere (foreigns) are subject to the Foreign Franchise Tax. Both taxes are contained in the same statute, Pa. Stat. Ann. Title 72, §7601, et seq. (Purdon Supp. 1982), and impose substantially equivalent taxes on subject corporations. For either tax, the base (capital stock tax value) is determined in identical

fashion, Id., §7601, and taxable value is determined by the application of apportionment factors, Id., §7602.

There are two apportionment methods provided. One is the three factor (tangible property, payroll and sales) method used in the majority of states and recently sanctioned by this Court in Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983). Pennsylvania's three factor approach is set out in Pa. Stat. Ann. Title 72, §7401(3)2(a)(10)-(17)(Purdon Supp. 1982).

The other apportionment method available under Pennsylvania law is based upon Pa. Stat. Ann. Title 72, §1896 (Purdon 1949). This method constructs a single fraction which expresses the proportion of non exempt assets to total assets, including in-

tangibles. The two apportionment formulae are set forth in the lower Court's opinion. Juris. Statement at 11a n.1, and 12a n.2.

Historically, domestic corporations were required to use the single factor approach, while foreign corporations were limited to the three factor method. Juris. Statement at 13a. In 1967, the Pennsylvania General Assembly determined that domestic corporations[1] should have the option to use either

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[1]Domestic corporations which do all of their business in Pennsylvania are ineligible to elect three factor apportionment. Only those domestics which both do business and are taxable in other states may so elect. Greenville Steel Car v. Commonwealth, 469 Pa. 444 (1976).

of these two apportionment methods, and amended the taxing statutes to so provide. Id., at 14a. This election is now found at Pa. Stat. Ann., Title 72, §7602 (Purdon Supp. 1982).

In Gilbert Associates, Inc. v. Commonwealth, 498 Pa. 514 (1982), this option was extended to foreign corporations when the Pennsylvania Supreme Court held that "foreign corporations must be afforded an option equivalent to the option . . . presently afforded only to domestic corporations." 498 Pa. at 516.

The decision in Gilbert Associates is grounded directly on the settled principle that discrimination between domestic and foreign corporations in matters of state taxation is impermissible unless rationally related to legitimate state purposes. Western &

Southern Life Ins. Co. v. State Board of Equalization of California, 451 U.S. 648 (1981); WHYY, Inc. v. Borough of Glassboro, 393 U.S. 117 (1968). In order to reach a result consistent with this principle, the nature of the option offered must be clearly understood.

The Pennsylvania Supreme Court has considered the nature of the apportionment option in Commonwealth v. After Six, Inc., 489 Pa. 69 (1980). In After Six, a domestic corporation sought to retain certain exemptions allowed to domestics utilizing single factor apportionment and to apply these exemptions in computing its elective three factor apportionment percentage. These same exemptions would not be available to a foreign corporation utilizing three factor apportionment. In holding that the single factor exemptions would not

be available to a taxpayer electing three factor apportionment, the Pennsylvania Supreme Court stated:

> It thus seems clear that a domestic taxpayer who elects to use the franchise tax method must be placed on exactly the same footing as a foreign corporation paying its franchise tax. . . .
>
> By electing to compute its tax by using the franchise tax formula, appellant must forego exclusions allowed domestic corporations which compute their tax using the single fraction formula.

489 Pa. at 81, 83

Thus, Pennsylvania's Supreme Court has interpreted the statutory option as a choice between being treated as a domestic (single factor) or foreign (three factor) corporation for all apportionment related purposes. If equivalence between domestic and foreign corporations for state taxation purposes is to be maintained, the holding in After Six

must require that foreign corporations electing single factor apportionment be treated for all apportionment purposes as domestics. This is precisely what was done in this case.

II. THE PENNSYLVANIA SYSTEM OF APPORTIONMENT IS CONSTITUTIONAL.

Appellant's narrow focus on the inclusion of intangibles in the construction of the single factor and its disingenuous framing of the issue as involving attempted extraterritorial taxation of intangibles serve only to avoid the real question in this case, namely, whether Pennsylvania has a constitutionally adequate system of apportionment. When the question is thus presented, Appellant cannot prevail.

Appellant isolates the single fraction as if it <u>had</u> to use the fraction rather than voluntarily choose it.

as an option, and then argues that it is unconstitutional for Pennsylvania to include intangible assets which should be assigned to New York on a business situs or reasonable relationship basis.

This Court has rejected this argument. In Mobil Oil Corp. v. Commissioner of Taxes of Vermont, 445 U.S. 475 (1980), this Court recognized the authority of the state of commercial domicile to tax intangibles, but stated further, at 446, that:

> . . . There is no reason in theory why that power [to tax intangibles] should be exclusive when the dividends reflect income from a unitary business, part of which is conducted in other states.

Similarly, in the companion case of Exxon Corp. v. Department of Revenue of Wisconsin, 447 U.S. 207 (1980), this Court noted that " . . . There is nothing talismanic about the concept of situs . . ." (at 230) for companies en-

gaged in unitary businesses, and that a ". . . 'rough approximation' of the corporate income that is 'reasonably related to the activities conducted within the taxing state. . .'" (at 223) was constitutionally adequate.

Appellant raises no claim that it is engaged in a non-unitary business, nor does it suggest any defect in Pennsylvania's three factor apportionment. Rather, its complaint is that a constitutionally unnecessary[2] option offered as a matter of legislative grace to

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[2]The option to choose three factor or one factor apportionment could be eliminated, as long as such elimination affected both domestic and foreign corporations equally. There is no question that the pre-option apportionment requirements would meet constitutional standards. Commonwealth v. Ford Motor Co., 350 Pa. 236 (1944), appeal dismissed for want of a substantial federal question, 324 U.S. 827 (1945).

provide an opportunity to reduce tax liability below that indicated by the standard three factor method is not generous enough.

III. THE RESULT SOUGHT BY THE APPELLANT WOULD CREATE AN UNCONSTITUTIONAL DISCRIMINATION BETWEEN FOREIGN AND DOMESTIC CORPORATE TAXPAYERS.

The result sought by the Appellant would, if allowed, destroy the constitutionally required equivalency of options now present in state law. In the current practice, all taxpayers utilizing the single factor are treated identically, as if they were domestic companies, and all taxpayers utilizing the three factor method are also treated identically, as if they were foreign companies. (S/F 11). This is in accordance with state law, Gilbert Associates, Inc. v. Commonwealth, 498 Pa. 514

(1982) and Commonwealth v. After Six, Inc., 489 Pa. 69 (1980), as well as federal law, WHYY, Inc. v. Borough of Glassboro, 393 U.S. 117 (1968) and Western & Southern Life Ins. Co. v. State Board of Equalization of California, 451 U.S. 648 (1981).

Appellant urges a result which would destroy this equivalence by creating a class of taxpayers (foreigns electing single factor treatment) which could exclude intangibles from apportionment, a result not otherwise available to domestics in any case or to foreigns using the three factor formula (which does not consider intangibles). The constitutionally required neutrality with respect to state of incorporation would be removed from Pennsylvania's corporate tax system.

CONCLUSION

For the reasons stated, the Commonwealth of Pennsylvania respectfully submits that the present appeal presents no substantial federal question, and that the questions on which the disposition of this matter would depend are so insubstantial as not to warrant further argument. On these grounds, the Commonwealth of Pennsylvania moves this Court to enter an order dismissing the present appeal, or, alternatively, to enter an order affirming the judgment of the Pennsylvania Supreme Court.

Respectfully Submitted,

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